

Nos. 05-4006, 05-4010 (consolidated)

IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

**WILLIAMS ELECTRONICS GAMES, INC., a Delaware Corporation, and NATIONAL
UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PA,**

Plaintiffs-Appellants,

v.

**JAMES M. GARRITY, ARROW ELECTRONICS, INC., and MILGRAY
ELECTRONICS, INC.,**

Defendants-Appellees.

Appeal from the United States District Court for the Northern District of Illinois
Eastern Division, No. 97 cv 3743. The Honorable Mark Filip, Judge Presiding.

**BRIEF OF DEFENDANT APPELLEE MILGRAY ELECTRONICS, INC.
n/k/a BELL INDUSTRIES, INC.**

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Oral Argument Requested

CIRCUIT RULE 26.1 DISCLOSURE STATEMENT

Appellate Court Nos.: 05-4006

Short Caption: Williams Electronics Games, Inc. v. Gregory S. Barry, Lawrence J. Gnat, Microcomp, Inc. and Milgray Electronics, Inc.

- (1) The full name of every party that the attorney represents in the case (if the party is a corporation, you must provide corporate disclosure information required by Fed. R. App. P 26.1 by completing item #3):

Milgray Electronics, Incorporated

- (2) The names of all law firms whose partners or associates have appeared for the party in the case (including proceedings in the district court or before an administrative agency) or are expected to appear for the party in this court:

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Sonnenschein, Nath & Rosenthal, 233 South Wacker, Chicago, IL 60606

- (3) If the party or amicus is a corporation:

- (i) Identify all parent corporations, if any; and

Bell Industries, Inc.

- (ii) list any publicly held company that owns 10% or more of the party's or amicus' stock:

None

Attorney's Signature: _____ Date: _____

Attorney's Printed Name: James R. Ferguson

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CIRCUIT RULE 26.1 DISCLOSURE STATEMENT

Appellate Court Nos.: 05-4010

Short Caption: National Union Fire Insurance Company of Pittsburgh, PA v. James M. Garrity, Arrow Electronics, Inc. and Milgray Electronics, Inc.

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STATEMENT REGARDING ORAL ARGUMENT

Milgray requests oral argument. Milgray believes that oral argument will aid materially in the consideration of the numerous issues involved in this appeal.

JURISDICTIONAL STATEMENT

Appellant's jurisdictional statement is not complete and correct.

The United States District Court for the Northern District of Illinois had jurisdiction prior to the first trial on the basis of 28 U.S.C. § 1331 and 28 U.S.C. § 1367(a). Plaintiffs brought this action under 18 U.S.C. § 1964(a) & (c), 15 U.S.C. §§ 1 & 15, 18 U.S.C. § 1965(a) & (b) and 28 U.S.C. § 1391.

After the mandate issued in *Williams v. Garrity*, 366 F.3d 569, the only remaining basis for jurisdiction was 28 U.S.C. § 1367(a). The District Court declined that jurisdiction under 28 U.S.C. § 1367(c), and Plaintiffs appeal from that order.

This is an appeal pursuant to 28 U.S.C. § 1291 from a final order dated September 15, 2005. Williams and National Union filed their notices of appeal on October 14, 2005.

STATEMENT OF THE ISSUES

Pursuant to F.R.A.P. 28 (i), Milgray adopts the Statement of Issues set forth in Arrow's Brief. In addition, in this Brief, Milgray will address the following issues:

1. Whether, in light of the Supreme Court's recent decision in *Unitherm Food Systems, Inc. v. Swift-Eckrich, Inc.*, 126 S.Ct. 980 (2006), Plaintiffs' failure to file a Rule 50(b) motion deprived this Court of the power to decide the "sufficiency of the evidence" issues that Plaintiffs now claim the Court decided in the first appeal.

2. Whether, in light of the Supreme Court's recent decision in *Unitherm*, Plaintiffs' failure to file a Rule 50(b) motion deprived this Court of the power to now enter judgment in Plaintiffs' favor.

3. Whether this Court should resolve disputed factual issues on appeal.

STATEMENT OF THE CASE

Pursuant to F.R.A.P. 28(i), Milgray adopts the Statement of the Case set forth in Arrow's brief. In this statement, Milgray will set forth the relevant procedural history that relates only to Milgray.

In the proceedings before the district court, Milgray asserted affirmative defenses based on ratification, *in pari delicto* and unclean hands. Milgray's *in pari delicto* defense emphasized Williams' role in furthering breaches of fiduciary duty by two former Milgray employees (Lawrence Gnat and Richard Slupik) who had used their own company (Microcomp) to secretly compete against Milgray by selling parts to Williams. Milgray also asserted that it was not aware of any kickbacks, and its prices to Williams were fair, reasonable and untainted by the alleged payments.

After a four-week trial, the jury returned its verdict finding that Williams had proven common law fraud as to Arrow and Milgray, but also finding that Milgray had proven the affirmative defenses of ratification and *in pari delicto*. *Williams Electronics Games, Inc. v. Garrity*, 2003 WL 164213, *1 (N.D. Ill. Jan. 22, 2003). Following the verdict, the district court denied Williams' motion for equitable relief on two alternative grounds: (1) Milgray's *in pari delicto* defenses established that Williams had "unclean hands"; and (2) Williams did not warrant equitable relief because it had suffered no injury as a result of the kickbacks paid to Barry. *Id.* at *6-*7.

After this Court reversed the jury's verdict in its entirety, *Williams Electronics Games, Inc. v. Garrity*, 366 F.3d 569, 580 (7th Cir. 2004) ("*Williams I*"), the case was reassigned on remand to a new judge (Filip, J.). Judge Filip subsequently exercised his discretion to decline to exercise supplemental jurisdiction (A. 35), and this appeal followed.

STATEMENT OF FACTS

Pursuant to F.R.A.P. 28(i) Milgray adopts the Statement of Facts contained in Arrow's brief. In this Statement of Facts, Milgray will focus solely on the facts relevant to (1) Bell Industries, which acquired Milgray in 1997 and is the real party in interest in this litigation; and (2) Gnat and Slupik's "Microcomp" fraud against Milgray.

A. Bell Industries

Although Milgray is the nominal defendant in this action, the real party in interest is Bell Industries, Inc. ("Bell"), which acquired Milgray's stock in January 1997 – before the complaint in this case had been filed, and the very month that Barry left Williams.¹ (S.A. 125, ¶¶64; S.A. 126, ¶5). At the time of the acquisition, Bell was a national distributor of electronic components that competed against Milgray, Arrow and many other vendors. (S.A. 126, ¶2). One of Bell's major customers in the 1990s was Williams Electronics Games, Inc. ("Williams"), which used the components to manufacture video games. (*Id.*).

Although Bell performed extensive due diligence before acquiring Milgray (including a thorough review of Milgray's records by outside auditors), the acquisition proved to be a disastrous decision. (S.A. 126, ¶¶6-7). Just months after the acquisition, Williams filed the instant lawsuit alleging that former Milgray employees Larry Gnat and Richard Slupik had paid kickbacks to Williams' buyer Greg Barry over the course of several years. Williams also charged several other companies with paying kickbacks to Barry, but did not name Bell as a defendant or otherwise claim that Bell paid kickbacks to Barry. Nor was there ever any evidence

1 Citations to "A.____" refer to the required short appendix attached to Plaintiffs' brief; citations to "S.A.____" refer to Plaintiffs' separate appendix; and citations to "R.____" refer to entries in the record on appeal.

showing that Bell participated in any corrupt scheme. (S.A. 127, ¶¶12-13). Rather, the sole reason Bell became embroiled in this litigation was its acquisition of Milgray's stock. (*Id.*).

In addition to the litigation, the Milgray acquisition created unexpected financial strains for Bell. Within two years, Bell found that it could no longer compete with the larger vendors in the electronics distribution business. (*Id.*, ¶¶9-10). Consequently, in 1999, Bell sold its electronics components business and exited the industry. (*Id.*, ¶¶11, 14). Bell today is a struggling regional company with 600 employees, focusing on its computer systems integration business in Indianapolis. (S.A. 127-128, ¶¶15-16, 19). Bell lost more than \$1 million in the year before trial and more than \$500,000 in the two months immediately preceding trial. (*Id.*, ¶¶17-18).

B. Facts Relevant To Plaintiffs' Complaint

1. Microcomp

Milgray's major defense in this case focuses on Microcomp, which Gnat and Slupik secretly operated for many years while they were supposed to be full-time Milgray employees. Gnat first formed the company in 1986 and enlisted Slupik to help with the business. (S.A. 128, ¶¶24-26). In 1987, Milgray discovered the existence of Microcomp and demanded that Gnat close the business or lose his job. (*Id.*, ¶27).

Although Gnat promised that he would sell his interest in the business, he actually restructured the company to conceal his ownership. (S.A. 128-129, ¶28). To this end, Gnat installed his wife as president, using the assumed name of "Linda Benedyk." (S.A. 129, ¶29). In addition, although Gnat ran the Microcomp business out of his Wisconsin home, he used a post office box in Illinois for all correspondence to conceal his involvement in the company. (*Id.*, ¶30). Finally, to conceal his commissions from Microcomp's sales, Gnat processed his commissions through a shell company called "LG Consulting." (*Id.*, ¶31).

In the fall of 1991, Gnat and Slupik told Barry that Microcomp could supply Williams with many of the parts that Milgray was selling to Williams. (S.A. 128-129, ¶¶25, 32). Gnat and Slupik thereafter agreed to pay Barry kickbacks in exchange for Barry's agreement to buy components from Microcomp. (*Id.*, ¶¶ 25-26). Pursuant to this agreement, between 1991 and 1997, Gnat and Slupik sold to Williams more than \$15 million worth of components through Microcomp. (S.A. 129, ¶32). Most of the components that Gnat and Slupik sold to Williams in this period were also components that Milgray sold to Williams. (*Id.*, ¶33). Indeed, in this period, Microcomp sold to Williams more than \$10 million worth of components that Milgray also sold to Williams. (*Id.*, ¶34).

Slupik and Gnat agreed to split 50-50 the gross profit dollars on Microcomp's sales, which resulted in a huge financial windfall. (S.A. 130, ¶40). In the period 1991-97, Gnat and Slupik each earned approximately \$2 million in commissions from Microcomp sales. (*Id.*, ¶42). This contrasted sharply with the commissions Gnat and Slupik earned on Milgray sales, which ranged from 2.75% to 10% of gross profit dollars. (*Id.*, ¶41). For example, in 1996, Gnat earned more than \$700,000 in commissions from Microcomp, while receiving only \$12,000 in commissions from Milgray. (*Id.*, ¶44).

Gnat and Slupik generated this income while working as full-time Milgray employees and supposedly devoting their best efforts to Milgray's best interests. Instead, Gnat and Slupik used Milgray's time and resources to further their own business at Milgray's expense. For example, as part of his Milgray duties, Slupik made forecasts of Williams' needs for specific components. (S.A. 129, ¶36). In many cases, Slupik told Milgray that Williams had little or no need for specific components in months when Microcomp was selling Williams those very same components. (*Id.*, ¶37). In addition, Slupik called on Williams' engineers as a Milgray sales

representative, but used the visits to determine what components Microcomp could sell to Williams. (S.A. 130, ¶38). Indeed, in his tax returns, Slupik claimed that nearly 50% of his visits to Williams — using a car and gasoline furnished by Milgray — were for the purpose of conducting Microcomp business. (*Id.*, ¶29).

Gnat, Slupik and Barry never disclosed to Milgray that Microcomp was still in business, or that it was still owned by Gnat and selling components to Milgray's customers. (S.A. 131, ¶51). For his part, Gnat did not disclose to anyone at Milgray that he operated Microcomp or that his wife was installed as President under her maiden name. (*Id.*, ¶52). Slupik also never disclosed to Milgray that he was selling components to Williams through Microcomp or that he entered into an agreement to receive 50% of the commissions of Microcomp sales to Milgray customers. (*Id.*, ¶53).

Barry assisted Gnat and Slupik by agreeing to divert Williams' purchases from Milgray to Microcomp in exchange for kickbacks. (S.A. 130-131, ¶45). He also assisted in concealing Microcomp from Milgray. Although he met several times with Milgray executives, Barry never told anyone at Milgray the truth. (S.A. 132, ¶54). Not surprisingly, therefore, in his testimony at trial, Barry freely admitted that he helped Gnat and Slupik cheat Milgray of their faithful and loyal services, and lost corporate opportunities. (S.A. 135, ¶47).

2. Williams and Microcomp

In 1996, Williams officials discovered that Gnat had an ownership interest in Microcomp and recognized that this created a conflict of interest. (S.A. 131, ¶49). Yet, Williams took no steps to investigate further or to alert Milgray because Williams had no interest in doing so. (*Id.*).

Williams established through its own witnesses at trial that the Microcomp relationship carried important benefits for Williams. Among other things, through the Microcomp sales,

Williams was able to obtain parts that were obsolete and difficult to obtain. (*Id.*, ¶48). Williams also benefited from the Microcomp sales by receiving good service, prompt delivery of allocated parts and prompt quotes. (*Id.*).

3. Milgray Did Not Overcharge Williams

Williams' own records established that the prices Milgray charged Williams for components were generally lower than the prices charged by other vendors who were unquestionably innocent, including Bell, Hallmark, Hamilton, Marshall, Pioneer and Wyle. (S.A. 134, ¶71). The evidence also showed that the Gross Profit Percentage ("GPP") that Milgray earned on sales of components to Williams was *lower* than the GPP that Milgray realized on the sale of the same parts to its other customers, as well as the GPP that other innocent vendors such as Bell realized on the sale of the same parts to Williams. (S.A. 135-136, ¶¶77-82). Indeed, Milgray's average GPP during this period was even lower than the GPP that Arrow realized on its sales to Williams *after* the alleged conspiracy ended. (S.A. 136, ¶83).

C. The Trial: Plaintiffs Fail To File A Rule 50 Motion

Between February 19 and March 14, 2002, the district court held a jury trial on the remaining legal claims against Milgray and the other defendants. After nearly four weeks of testimony, the jury found that Plaintiffs had proved the elements of common law fraud as to each of the defendants, but also found that Arrow and Milgray had proved the defenses of ratification and *in pari delicto*. On this basis, the jury returned a verdict of "no liability" as to Milgray on Williams' legal claims. Judge Gettleman thereafter denied Plaintiffs' motion for judgment on the remaining equitable claims asserted in Counts IV (inducement of breach of duty claim) and VIII (equitable accounting and constructive trust claim).

At no point in the case – either before or after the jury's verdict – did Plaintiffs file a Rule 50 motion which "*specif*[ied] the judgment sought, *and* the law and the facts on which the

moving party is entitled to judgment.” Fed.R.Civ.P. 50(a)(2) (emphasis added). Indeed, Plaintiffs did not file a Rule 50(b) motion of *any* kind or make any other post-verdict request for a new trial as to Milgray and Arrow. Instead, Williams filed only a single post-verdict motion: a motion for a new trial against Garrity on damages and for the assessment of pre-judgment interest. (R. 461).

D. Williams’ Appeal

In its subsequent appeal, Plaintiffs claimed that (*inter alia*) the district court erred by submitting the ratification and *in pari delicto* defenses to the jury. In their responsive briefs, Milgray and Arrow argued at length that Plaintiffs’ failure to file a proper Rule 50 motion precluded any challenge to the propriety of their affirmative defenses. (*Arrow Williams I Br.*, 21-26; *Milgray Williams I Br.*, 12-14) In so doing, Milgray and Arrow relied on cases from this Circuit holding that the failure to file a proper Rule 50 motion forecloses any appellate challenge to either: (1) the district court’s decision to submit an affirmative defense to the jury; or (2) the sufficiency of the evidence supporting the jury’s verdict sustaining the defense. *See, e.g., Savino v. C.P. Hall Co.*, 199 F.3d 925, 931 (7th Cir. 1999).

Notwithstanding this authority, the *Williams I* opinion did not address the Rule 50 arguments made by Milgray and Arrow. Instead, the opinion proceeded directly to the merits of Plaintiffs’ challenge to the specific instructions given at trial, finding the instructions to be both “erroneous” and “confusing.” *Williams I*, 366 F.3d at 573-4. On this basis, the Court reversed the jury’s verdict in its entirety (including the finding of *prima facie* fraud) and remanded the case for a new trial on all issues. *Id.* at 574.

E. The District Court Dismisses The Complaint

On remand, the case was reassigned to Judge Filip. In reviewing Plaintiffs’ subsequent summary judgment motion, Judge Filip raised the question of whether the court should continue

to exercise federal jurisdiction over Plaintiffs' remaining state law claims. (A. 22). After receiving briefs from both parties on the question, Judge Filip issued a Memorandum Opinion and Order on September 15, 2005. In the 21-page opinion, Judge Filip set forth the analysis supporting his discretionary decision to decline to exercise supplemental jurisdiction and to dismiss Plaintiffs' complaint without prejudice. (A. 14-45). Plaintiffs filed a notice of appeal on October 14, 2005.

F. The Supreme Court Decides *Unitherm*

On January 23, 2006 – more than three months after Williams filed its Notice of Appeal from the district court's dismissal of its Complaint – the Supreme Court decided *Unitherm Foods Systems, Inc. v. Swift-Eckrich, Inc.*, 126 S.Ct. 980 (Jan. 23, 2006). In that case, the Supreme Court held that a party's failure to file a Rule 50(b) motion deprives an appellate court of the power to direct the entry of any judgment that is contrary to the judgment entered by the district court. *Id.* at 985. The Supreme Court further held that a party's failure to make a post-verdict request for a new trial similarly deprives an appellate court of the power to order a new trial on appeal. In reaching this result, the Court broadly held that a “party is not entitled to pursue a new trial on appeal *unless that party makes an appropriate post verdict motion in the district court.*” *Id.* at 987 (emphasis added).

SUMMARY OF ARGUMENT

In the proceedings before the district court, Milgray did not object to the court's retention of federal jurisdiction, but acknowledged that Judge Filip had the discretion to dismiss Williams' state law claims. This remains Milgray's position on appeal. Accordingly, pursuant to F.R.A.P. 28(i), Milgray adopts the arguments set forth in Arrow's brief (at 14-36) explaining why Judge Filip properly exercised his discretion in declining to exercise supplemental jurisdiction.

In the remainder of this brief, Milgray will address Plaintiffs' additional claims that (1) in *Williams I* this Court "decided" a series of factual issues that had been sharply disputed at trial; (2) in the same decision, the Court held that Milgray's affirmative defenses were "insufficient" as a matter of law; and (3) for these reasons, the Court should now enter summary judgment on Plaintiffs' behalf. These arguments fail for three independent reasons.

First, the arguments are directly contrary to the holding in *Williams I*. In that decision, the Court expressly denied the same request that Plaintiffs make here – *i.e.*, a request for an order directing the entry of summary judgment on appeal. Instead, the Court set aside the *entire* jury verdict – including the jury's findings of fraud – and remanded the case for a new trial on *all* issues. This holding squarely refutes Plaintiffs' claims to the contrary.

Second, the Supreme Court's recent decision in *Unitherm* makes clear that Plaintiffs' failure to comply with Rule 50 deprived this Court of the power to decide the very issues that Plaintiffs now claim it decided. In particular, under *Unitherm*, Plaintiffs' failure to file a Rule 50 motion precluded this Court from (1) holding in *Williams I* that the evidence at trial established *as a matter of law* the impropriety of Milgray's affirmative defenses; and (2) directing the entry of summary judgment for Plaintiffs in this appeal.

Third, even if the Supreme Court’s decision in *Unitherm* could be ignored, this Court should not resolve disputed factual issues on appeal. The Supreme Court has repeatedly held that an appellate court lacks the necessary experience and expertise to make factual findings on its own. *Icicle Seafoods, Inc. v. Worthington*, 475 U.S. 709, 714 (1986). Under this rule, the Court should not decide on appeal such fact-laden issues as (1) whether Milgray employees Gnat and Slupik bribed Barry on behalf of Milgray, or on behalf of their own company which they were secretly using to defraud Milgray; or (2) whether Milgray charged higher prices or received any other benefit as a result of the alleged fraud.

Each of these points is developed below.

ARGUMENT

I. PLAINTIFFS’ ARGUMENTS ARE CONTRARY TO THIS COURT’S HOLDING IN WILLIAMS I

In their major argument on appeal, Plaintiffs claim that in *Williams I* this Court made the following factual “findings” relating to Milgray:

1. two Milgray employees bribed Williams’ purchasing agent on behalf of *Milgray* (rather than on behalf of their own company which they were using to defraud Milgray);
2. the two employees therefore acted within the scope of their *Milgray* employment for purposes of *respondeat superior*; and
3. the evidence at trial established the “insufficiency” of Milgray’s affirmative defenses as a matter of law.

(Plaintiffs’ Br., at 28-41).

Plaintiffs further argue that, under the “law of the case” doctrine, Judge Filip wrongfully ignored the above findings in analyzing the factors relevant to the exercise of supplemental federal jurisdiction. (*Id.*, at 36-41). Finally, Plaintiffs assert that, based on the same findings, the

Court should now grant summary judgment on Plaintiffs' equitable claims and remand the case for a hearing on damages. (*Id.*, at 46-53).

These arguments are directly contrary to the holding of *Williams I*. In that decision, the Court ruled that the instructions given to the jury were both "confusing" and "erroneous" in several "fundamental" respects. For this reason, the Court remanded the entire case for a new trial on all issues, while denying Plaintiffs' request for the entry of judgment on appeal – a request that was virtually identical to the request that Plaintiffs now make here:

So Williams is entitled to a new trial on fraud – but not, as it urges, to a judgment based on the jury's finding of *prima facie* fraud. The jury *may* have based its findings of ratification and equal fault simply on negligence by Williams – the instructions would have permitted that – in which event Williams would be entitled to a judgment. But, again given the confusing medley of instructions, we cannot have any confidence that that was the jury's thought process.

Id. at 574-75 (emphasis in the original).

Thus, as the above language makes clear, the Court found the jury instructions to be so "confusing" that the Court could not determine exactly how the jury arrived at its verdict. For this reason, the Court refused to enter judgment for Williams based on the jury's finding of fraud. Instead, the Court set aside the *entire* verdict – including the jury's findings of fraud – and remanded the case for a new trial on *all* issues. *Id.* at 580. In reaching this result, the Court did not direct the trial judge to find on remand that "Milgray bribed Barry" or that Gnat or Slupik acted within the scope of their employment. Rather, the Court left these issues – and all other questions of fact – to be decided by the trier of fact based on a complete evidentiary record.

Furthermore, while the Court plainly found the jury *instructions* to be erroneous, it did not hold that the underlying *defenses* were invalid as a matter of law. On the contrary, as noted above, the Court remanded the case for a new trial precisely because it could not tell whether the

jury based its “affirmative defense” findings on a permissible or an impermissible ground. *Id.* at 574-75. This holding plainly shows that the two defenses would have been permissible if the jury had been given a properly-worded instruction for each defense. Indeed, the Court would have no reason to focus on the “jury’s thought process” (or the “confusing” nature of the jury instructions) if the Court believed the defenses were “insufficient” as a matter of law. Plaintiffs’ arguments to the contrary simply cannot be squared with the unambiguous language of the Court’s opinion.

To be sure, with respect to the ratification defense, Plaintiffs emphasize the Court’s statement in *Williams I* that, in the first trial, “no ratification instruction should ever have been given.” 366 F.3d at 573. This statement, however, merely reflected the Court’s observation that defendants’ theory in the first trial had been that “Williams knew *all along* about Barry’s bribe-taking” – as opposed to a claim that Williams *later* learned about the bribe-taking and then ratified it. *Ibid.* (emphasis added). In making this statement, the Court did not hold that, as a matter of law, defendants could not present *any* evidence on remand to support a ratification defense. On the contrary, the Court specifically noted that defendants could establish a valid ratification defense by showing (*inter alia*) that Williams decided not to fire Barry *after* discovering the bribes. *Ibid.* The Court further noted that the factual issue of whether Williams “kn[ew] about the bribes but [did] not care because it thought it was getting a good price and excellent service from Arrow and Milgray” was a “matter of fierce dispute.” *Id.* at 572.

Finally, as shown below, under the Supreme Court’s recent decision in *Unitherm*, this Court could not have held that the ratification and *in pari delicto* defenses were “insufficient” as a matter of law because Plaintiffs failed to file a Rule 50(b) motion of any kind.

II. WILLIAMS' PROCEDURAL DEFAULT DEPRIVED THIS COURT OF THE POWER TO ENTER JUDGMENT FOR PLAINTIFFS OR HOLD THAT MILGRAY'S AFFIRMATIVE DEFENSES WERE "INSUFFICIENT"

Even if the holdings and rationale of *Williams I* could be ignored, Plaintiffs' "law of the case" arguments must be rejected for an entirely separate reason. Under the Supreme Court's recent *Unitherm* decision, Plaintiffs' failure to file a Rule 50(b) motion deprived the Court of the power to hold either that (1) Milgray's affirmative defenses were "insufficient" as a matter of law; or (2) judgment should now be entered in Plaintiffs' favor.

In *Unitherm*, the Supreme Court addressed the purpose and scope of Rule 50(b), which requires a party to file a motion for a new trial or judgment NOV within ten days of the entry of judgment. Fed.R.Civ.P. 50(b). The Rule provides in relevant part:

(b) RENEWING MOTION FOR JUDGMENT AFTER TRIAL; ALTERNATIVE MOTION FOR NEW TRIAL. If, for any reason, the court does not grant a motion for judgment as a matter of law made at the close of all the evidence . . . [t]he movant may renew its request for judgment as a matter of law by filing a motion no later than 10 days after entry of judgment – and may alternatively request a new trial or join a motion for a new trial under Rule 59. In ruling on a renewed motion, the court may:

- (1) if a verdict was returned:
 - (A) allow the judgment to stand,
 - (B) order a new trial, or
 - (C) direct entry of judgment as a matter of law . . .²

Id. In construing this language, the Supreme Court noted that an application under Rule 50(b) is "not an idle motion," but an "essential part of the Rule, firmly grounded in principles of fairness." *Id.* at 986 (quoting *Johnson v. New York, N.H. & H.R. Co.*, 344 U.S. 48 (1952)). In particular, the Rule rests on the recognition that, in cases where post-verdict relief is appropriate,

² As shown in the quoted language, Rule 50(b) cross-references Fed.R.Civ.P. 59, which is the other procedural vehicle for making a post-verdict motion for a new trial. In this case, Plaintiffs did not make a post-verdict motion for a new trial as to Milgray or Arrow under Rule 50(b) or Rule 59.

the court best suited to determine whether the relief should be a new trial or judgment NOV is the trial court, which “saw and heard the witnesses and has the feel of the case which no appellate printed transcript can impart.” *Id.* at 985-86 (quoting *Cone v. West Virginia Pulp & Paper Co.*, 330 U.S. 212, 218 (1947)).

Consistent with these principles, the *Unitherm* Court held that a party’s failure to comply with Rule 50(b) not only precludes the appellate court from directing the entry of judgment on appeal, but also forecloses the court from granting a new trial. *Id.* at 985-7. Indeed, in *Unitherm*, the Supreme Court broadly held that “a party is not entitled to pursue a new trial on appeal *unless that party makes an appropriate post verdict motion in the district court.*” *Id.* at 987 (emphasis added).

Unitherm also made clear that a party’s compliance with Rule 50 is not merely a procedural nicety, but a fundamental requirement for the exercise of appellate power. Under this principle, if a party fails to file a Rule 50(b) motion seeking judgment NOV or, alternatively, a new trial, the procedural default “*deprives the appellate court of the power*” to direct the entry of judgment in favor of that party or to grant a new trial. *Id.* at 985 (emphasis added).

By emphasizing the link between appellate power and compliance with Rule 50, *Unitherm* comports with other Supreme Court decisions. For example, in *Johnson*, the defendant filed a timely Rule 50(b) motion requesting a new trial, but did *not* request the entry of judgment NOV. 344 U.S. at 49. On these facts, the Supreme Court held that the appellate court could only order a new trial because the failure to file a post-verdict motion requesting judgment NOV deprived the appellate court of the “power” to render judgment for the defendant. *Id.* Likewise in *Cone*, the Supreme Court held that, as a direct result of the defendant’s failure to file a Rule

50(b) motion, the appellate court was “without *power*” to enter a judgment contrary to the judgment entered by the district court. 330 U.S. at 218 (emphasis added).

The same principle applies here. As noted earlier, Plaintiffs failed to file a Rule 50(b) motion requesting *either* a judgment NOV *or* a new trial as to Milgray and Arrow. While Milgray and Arrow argued the procedural default at length in their *Williams I* briefs,³ this Court did not decide or address the Rule 50 issues in its opinion.

Nevertheless, in light of *Unitherm*, it is now clear that, at a minimum, Plaintiffs’ procedural default foreclosed any appellate ruling that the evidence was insufficient to support Milgray’s ratification and *in pari delicto* defenses.⁴ *Fuesting v. Zimmer, Inc.*, No. 04-2158 (slip op.), at 5 (7th Cir. May 22, 2006). Consequently, under *Unitherm*, the Court in *Williams I* could not have held (as Plaintiffs now argue) that the two defenses were “insufficient” as a matter of law. *Id.*

Similarly, by virtue of Plaintiffs’ Rule 50 default, this Court does not now have the power to direct the entry of a judgment that is contrary to the original judgment entered by the district court. In *Unitherm*, the Supreme Court reaffirmed that, in the absence of a Rule 50(b) motion, an “appellate court is *without power* to direct the District Court to enter judgment contrary to the one it had permitted to stand.” *Id.* at 985 (emphasis added) (*quoting Cone*, 330 U.S. at 218).

Thus, under *Unitherm*, this Court did not have the power in *Williams I* to decide the issues that Plaintiffs now claim it decided, nor does it have the power to now grant the relief that

³ See, e.g., Arrow *Williams I* Brief, at 21-29; Milgray *Williams I* brief, at 12-13.

⁴ This Court’s recent decision in *Fuesting* appears to limit *Unitherm* to appellate challenges to the sufficiency of the evidence, notwithstanding the “strong language [in *Unitherm*] regarding the necessity of postverdict motions” for *any* appellate review. *Id.* (slip op.), at 6. Under this narrow reading of *Unitherm*, this Court had the power in *Williams I* to order a new trial based on the erroneous jury instructions discussed in the *Williams I* opinion—but not based on the alleged insufficiency of the evidence supporting Milgray’s defenses.

Plaintiffs request in this appeal. *Unitherm* therefore provides a wholly independent basis for rejecting Plaintiffs' arguments.

III. AN APPELLATE COURT SHOULD NOT DECIDE DISPUTED FACTUAL ISSUES ON APPEAL

Finally, even if *Unitherm* could be ignored, Plaintiffs' "law of the case" arguments should be rejected for a third reason: Having set aside the jury's verdict in its entirety, 366 F.3d at 580, this Court should not now proceed to resolve disputed factual issues on appeal. The Supreme Court has long recognized that courts of appeal are not well-suited to decide disputed issues of material fact. Indeed, in *Icicle Seafoods*, the Court reversed the Ninth Circuit because the appellate court had made a series of factual findings relating to the nature of the maritime employment at issue in the case. 475 U.S. at 714. In reaching this result, the Court stressed that an appellate court does not have the background of a trial judge in resolving disputed issues of material fact:

The trial judge's major role is the determination of fact, and with experience in fulfilling that role comes expertise. Duplication of the trial judge's efforts in the court of appeals would very likely contribute only negligibly to the accuracy of fact determination at a huge cost in diversion of judicial resources.

Id. (quoting *Anderson v. Bessemer City*, 470 U.S. 564, 574-75 (1985)).

The same logic applies here. Indeed, as shown below, this principle applies to at least three separate factual issues arising from Plaintiffs' equitable claims against Milgray.

A. A Material Factual Dispute Exists As to Whether Gnat or Slupik Were Acting Within the Scope of their Employment

The central factual issue in Plaintiffs' equitable claims against Milgray is whether former Milgray employees Gnat and Slupik bribed Barry on behalf of Milgray, or on behalf of their own company which they secretly used to enrich themselves by competing against Milgray. This issue arises from evidence showing that the two former employees committed a vast fraud

against Milgray by means of an illicit side-business called Microcomp, which they used to sell electronic components to Milgray's own customers at the same time they were full-time Milgray employees. *See Williams I*, 366 F.3d at 575.

This evidence alone raises a material factual dispute as to whether Gnat and Slupik were acting within the scope of their employment when they allegedly paid kickbacks to Barry. As *Williams I* recognized, if Gnat and Slupik paid the kickbacks on behalf of their secret business – and to Milgray's detriment – they plainly could not be deemed to be agents of Milgray:

[I]n general when an agent acts entirely on his own behalf, doing things that could not possibly be interpreted as the merely overzealous or ill-judged performance of his duties as agent, he is acting outside the scope of the agency and the principal is not bound.

366 F.3d at 575 (quoting *Hartmann v. Prudential Ins. Co. of America*, 9 F.3d 1207, 1210 (7th Cir. 1993)).

Williams' theory is that the two former employees bribed Barry on behalf of both entities – usually for Microcomp, but sometimes for Milgray. (S.A. 156). However, to support this theory, Williams relies *solely* on the uncorroborated testimony of a single witness – Greg Barry – whom the district court and the jury both found to be unworthy of belief. The district court expressly found that Barry was “thoroughly and convincingly impeached” by his prior deposition testimony which directly contradicted his claims at trial. *Williams*, 2003 WL 164213, at *3. In addition, Barry had a long and well-documented history of deception that did not end with his departure from Williams, as Barry continued to lie even after he began to cooperate with Williams in the litigation of this case. (S.A. 134, ¶68).

Not surprisingly, therefore, Judge Gettleman and the jury both rejected Barry's testimony on virtually every contested issue at trial, including the alleged “damages” suffered by Williams.

Ibid.; 2003 WL 164213, at *7. Yet, despite the obvious credibility issues surrounding Barry, Williams cites no evidence to corroborate Barry's claims as to Milgray.

For example, Williams cites no evidence showing that Milgray executives had any knowledge of the alleged fraud, or that Gnat and Slupik paid the kickbacks with money from Milgray (as opposed to money from their huge Microcomp profits). Nor does Williams cite any documentary or testimonial evidence supporting Barry's claims that Gnat or Slupik paid kickbacks on behalf of Milgray, rather than Microcomp. This is true even though Williams called *as its own witness* at trial former defendant Larry Gnat, who had settled with Williams before trial and who was plainly in a position to support Barry's claims. Yet, in his testimony, Gnat not only failed to corroborate Barry's claims, but flatly denied that Barry had ever asked him to pay any kickbacks at all:

Q. Mr. Gnat, when Mr. Barry was at Williams Electronics Games, did he ever ask you to pay him any money for sending purchase orders to Milgray?

A. No, he did not.

(S.A. 132, ¶56).

Williams not only fails to cite any evidence corroborating Barry's claims as to Milgray, but also disregards the entire body of evidence impeaching those claims. For example, Williams disregards the evidence showing that Gnat and Slupik had a financial incentive to bribe Barry to buy components from Microcomp rather than Milgray. This evidence showed that Slupik and Gnat each received 50% of the gross profit dollars on Microcomp sales, but only a far smaller percentage of gross profit dollars on Milgray sales. (S.A. 130, ¶¶40-41). This resulted in a substantial difference in the amount of money that Gnat and Slupik made by selling components to Williams through Microcomp as opposed to Milgray. For example, in 1996, Gnat earned

more than \$700,000 in commissions from Microcomp, while receiving only \$12,000 in commissions from Milgray. (*Id.*, ¶44).

As a result, Gnat and Slupik had no incentive to use their own funds to bribe Barry to buy parts from *Milgray*, since every part that Williams bought from Milgray was one less part that the two employees could sell at a huge personal gain through Microcomp. This fact was conceded by Barry at trial:

Q. Didn't you know that Mr. Slupik and Mr. Gnat would make a lot more money if they sold a component to you through Microcomp than they would if they sold it through Milgray and only got a sales commission?

A. Yes.

Q. And so wouldn't you agree with me, Mr. Barry, that Mr. Gnat and Mr. Slupik had a financial incentive to sell your components through Microcomp rather than Milgray?

A. Yes.

(S.A. 132, ¶57). This testimony directly undercuts Plaintiffs' claims that (i) Gnat and Slupik bribed Barry on behalf of Milgray; and (ii) Milgray therefore participated in Barry's breach of fiduciary duty. Milgray could not have "participated" in any breach induced by Gnat and Slupik if the two employees were acting for their own benefit.

To be sure, in its brief, Plaintiffs cites this Court's parenthetical comment in *Williams I* that "Milgray as well as Arrow bribed" Barry. 366 F.3d at 575. However, it is well-settled that a "recital [of facts] in an appellate opinion is hardly the equivalent of findings made by the trier of the facts." *Beck v. Ohio*, 379 U.S. 89, 93 (1964). This is particularly true when the appellate court then vacates the jury's verdict and remands the *entire* case for a new trial on all issues – including the finding of *prima facie* fraud.

Accordingly, Plaintiffs' case against Milgray rests entirely on the uncorroborated testimony of a witness whose claims against Milgray were contradicted by the other evidence at

trial (including Plaintiffs' own witness) and whose testimony was repeatedly rejected by both the trial court and the jury. This reliance on a witness who was "thoroughly and convincingly impeached" at trial should foreclose any fact finding by this Court on appeal. *Icicle Seafoods*, 475 U.S. at 714-15.

B. A Material Factual Dispute Exists As To Whether Williams Suffered Any Damages (or Milgray Received Any Benefit) as a Result of the Alleged Breach.

In the first trial, the jury and the district court both found that (1) Williams paid competitive prices for the components it purchased from Arrow and Milgray; and (2) Williams would have done business with Arrow and Milgray even in the absence of the kickbacks. Based on these findings, the trial court held that Williams "utterly failed to convince the jury or this court that [Williams] was harmed in any way by the kickbacks to Barry, except perhaps by Barry's failure to return the kickbacks to plaintiff." *Williams*, 2003 WL 164213, at *7.

These findings rested on evidence showing that the prices Milgray charged Williams for components were generally lower than the prices charged by other vendors who were unquestionably innocent, including Bell, Hallmark, Hamilton, Marshall, Pioneer and Wyle. (S.A. 134-135, ¶¶70-76). The evidence also showed that the Gross Profit Percentage ("GPP") that Milgray earned on sales of components to Williams was lower than the GPP that Milgray realized on the sale of the same parts to its other customers, as well as the GPP that other innocent vendors such as Bell realized on the sale of the same parts to Williams. (S.A. 135-136, ¶¶81-82). This evidence creates disputed issues of material fact which should not be resolved by this Court on appeal. *Icicle Seafoods*, 475 U.S. at 714-15.

C. A Material Factual Dispute Exists As To Milgray's Affirmative Defenses.

As shown above, for a wide range of reasons, Plaintiffs are categorically wrong when they claim that this Court "conclusively dispos[ed]" of all of Milgray's factual and affirmative

defenses (*e.g.*, scope of employment, *in pari delicto* and unclean hands). (Williams Br., 25). To begin with, as Arrow has shown in its brief (at 28-31), a material factual dispute exists as to whether Williams knew of Barry's kickback scheme or was recklessly indifferent to it. This Court expressly recognized that such knowledge or reckless indifference is sufficient to defeat Williams' fraud claim. For this reason, such a showing constitutes an independent affirmative defense as to the fraud claim, as well as an "unclean hands" defense to Williams' equitable claim. *TRW Title Insurance Co. v. Security Union Title Insurance Co.*, 153 F.3d 822, 829 (7th Cir. 1998).

In addition, as shown above, this Court did not hold that Milgray's *in pari delicto* defense (based on the Microcomp fraud) was "insufficient" as a matter of law. Rather, the Court held that the *instructions* on this defense were erroneous – and thus needed to be reformulated on remand. 366 F.3d at 575.

On this score, the record in this case raises material factual disputes as to whether Williams authorized or ratified Barry's conduct in facilitating the Microcomp fraud. Indeed, the evidence shows that Williams' senior management learned of Gnat's involvement in Microcomp – and the resulting "conflict of interest" – but did nothing to alert Milgray or to investigate Barry's involvement. (S.A. 133-134, ¶¶61-67). The evidence also shows that Williams reaped substantial benefits from its relationship with Microcomp, including obtaining scarce components on a timely basis and receiving service comparable to the service provided by much larger companies such as Arrow and Milgray. (S.A. 131, ¶48). These core facts of record, which are common to both the *in pari delicto* defense and the unclean hands doctrine, create material factual disputes which should not be resolved on appeal. *Icicle Seafoods*, 475 U.S. at 714-15.

IV. FORCING BELL TO PAY RESTITUTION WOULD BE INEQUITABLE

In addition to the disputed factual issues described above and in Arrow's brief, another ground exists for denying Plaintiffs' request for an order directing the entry of judgment: In weighing equitable claims, a court must apportion relative culpability, *Banco Indus. de Venez. C.A. v. Credit Suisse* ("BIV"), 99 F.3d 1045, 1051 (11th Cir. 1996), as well as consider the "relative benefits and hardships in crafting appropriate and just remed[ies]." *Glenn v. City of Chicago*, 628 N.E. 2d 844, 845 (Ill. App. Ct. 1st Dist. 1993) (emphasis added). This is particularly true since equitable relief should be remedial, not punitive. *Rowe v. Maremont Corp.*, 850 F.2d 1226, 1241 (7th Cir. 1988). In this case, the disgorgement of Milgray's alleged "profits" from Bell would be inequitable and punitive for at least four reasons.

First, the evidence shows that Williams did not suffer any harm as a result of the kickbacks that Gnat and Slupik allegedly paid on behalf of Milgray. To the contrary, Williams' own records reveal that the prices Milgray charged Williams were generally lower than the prices charged by other vendors who were not alleged to be participants in the alleged scheme. (S.A. 134-135, ¶¶70-76). In addition, the Gross Profit Percentage ("GPP") that Milgray earned on sales of components to Williams was *lower* than the GPP Milgray realized on sales of the same parts to its other customers — and lower than the GPP that innocent vendors such as Bell realized on the sale of the same parts to Williams. (S.A. 135-136, ¶¶76-82). Based on this evidence, Judge Gettleman expressly found that Williams suffered no harm from the kickbacks that Milgray's former employees paid to Barry. *Williams*, 2003 WL 164213, at *7. As a result, "[t]here is nothing to be restored," and any disgorgement from Bell would result in a "windfall to plaintiff." *Id.*

Second, based on an "apportionment of culpability," *BIV*, 99 F.3d at 1051, the disgorgement remedy would be especially inequitable in this case because Bell engaged in no

wrongdoing against Williams or any other party. Williams did not allege that Bell was a participant in any scheme to defraud Williams, and Williams did not prove at trial that Bell paid any kickbacks to Barry. (S.A. 127, ¶¶12-13). Bell thus stands as a factually innocent party that finds itself embroiled in this litigation only because it had the great misfortune to acquire Milgray's stock shortly before Barry left Williams.

Third, if this Court were to award Williams' requested relief, it would result in an extraordinary hardship on innocent third parties. Bell today is a struggling regional company with 600 employees. (S.A. 127-128, ¶¶15-17, 19). Bell is no longer involved in the distribution of electronic components, focusing instead on computer systems integration and a recreational products business. *Id.* Bell lost more than \$1 million in the year before trial and more than \$500,000 in the two months before trial. (S.A. 128, ¶18). In these circumstances, a court order directing Bell to disgorge Milgray's profits would cause grievous harm to Bell's 600 employees, as well as to other innocent third parties who had nothing to do with any of the alleged wrongdoing in this case.

Fourth, if this Court were to order Bell to disgorge Milgray's alleged profits, it would serve no meaningful deterrent function, which is an important consideration in allowing disgorgement. *Maremont*, 850 F.2d at 1241. As noted earlier, Bell is no longer in the business of distributing electronic components, so any disgorgement award would have minimal deterrent value.

V. MILGRAY ADOPTS ARROW'S ARGUMENTS

As noted earlier, pursuant to F.R.A.P. 28(i), Milgray adopts the arguments set forth in Arrow's brief.

VI. CONCLUSION

For the above-stated reasons, Milgray respectfully requests that this Court affirm the judgment of the district court and deny Plaintiffs' request for an order directing the entry of summary judgment.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE WITH CIRCUIT RULE 31(e)(1)

The undersigned, counsel for Defendant-Appellee/Defendant-Cross-Plaintiff-Cross-Appellant, Milgray Electronics, Inc., certifies that the cd accompanying this brief includes the content of the brief in non-scanned PDF format, but does not include appendix materials that are not available electronically.

By: _____
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CERTIFICATE OF SERVICE

James R. Ferguson, an attorney, certifies that he caused two copies of the foregoing brief to be served on each of the counsel listed below by depositing said copies in the U.S. Mail drop at 71 South Wacker Drive, Chicago, IL, postage pre-paid, prior to 6:00 p.m. on May 24, 2006.

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